

A L E R T

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DID HURRICANE SANDY JUST GIVE YOU AN OPPORTUNITY TO RENEGOTIATE YOUR OUTSOURCING AGREEMENTS?

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Recent events along the Atlantic seaboard bring attention to the need to prepare for the worst. Hurricane Sandy knocked down power lines and flooded telecommunications circuitry. Many businesses were shut down for days, unable to access vital computer records and data, as well as telephone and voicemail systems, which created real losses to those businesses and the economy.

At the same time, some businesses, even in lower Manhattan which was one of the hardest hit areas, were up and running the next day. Productivity and business losses were kept at a minimum. Why this discrepancy in experiences? Is there any way to recoup these losses or prevent them in the future?

Outsourcing service providers would claim that Sandy was to blame, that this was a force majeure event, and that the service provider's failure to perform should be excused. But is that really the case? Most outsourcing agreements have force majeure clauses. These clauses may excuse service providers' performance because some unforeseen circumstance prevents that performance. But not all force majeure clauses are the same.

Just to review, force majeure is a defense based on the concept that "Acts of God" or other unexpected events prevent a party from complying with its contractual obligations. Extreme weather conditions, like a hurricane, are considered "Acts of God" (a typical event listed in these clauses). Courts have ruled that inclement weather that actually prevents a defendant from performing its contractual obligations will excuse that failure to perform.

But, there is no one size fits all force majeure clause and courts typically construe force majeure clauses narrowly. Courts do not normally accept events not expressly described in the force majeure clause as an excuse for non-performance.

Further, force majeure cannot be invoked to hide a service provider's negligence. Service providers should take rea-

sonable precautions against hurricanes, knowing that they do occur on the Atlantic seaboard almost every year. The service provider cannot just ignore this fact, build a call center in a low lying area, and then cry force majeure when the center is flooded. Any loss in this situation would likely not constitute a force majeure event.

Typically, defendants bear the burden of proof to establish that an event would constitute a force majeure. In fact, force majeure clauses rarely result in a valid defense of a service provider's non-performance. Further, courts do not typically excuse performance of the primary service provider, in the event that some of the failed services are provided by third party service providers.

How does this all relate to Sandy? If your company is faced with a breach of contract by an outsourcing vendor, it is likely that vendor will try to rely on the force majeure clause. However, further investigation is warranted. While you can't cancel existing contracts (unless there truly was a breach) companies should closely examine existing contracts and ask tough questions.

First, is there a force majeure clause that could potentially excuse the service provider's performance? If yes, it should be reviewed in the context of the events caused by Sandy to determine if any circumstances occurred which would support a defense by the vendor for its failure to perform. Also, it would be helpful to make a realistic estimation of any damages. The greater the damages, the more likely a renegotiation or even litigation may be beneficial.

Has the vendor otherwise performed all of its obligations under the agreement? If not, this could be a breach and lead to either a termination or renegotiation of the agreement.

Are all obligations excused or just some? Not all vendor obligations should be excused, just those that were directly affected by the force majeure event. A flooded telecom cir-

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cuit does not mean the vendor is excused from its obligations to comply with data security requirements.

Are any of the customer's obligations relieved? Is the customer's obligation to pay, for instance, relieved or at least tolled? Most importantly, is it time to renegotiate?

Some say, there is no need for a Category 1 Hurricane to shut down your business. Telecommunications and IT infrastructure, including email, voicemail, and document management, functions can now all be managed remotely, with operations being almost anywhere on the planet. The use of redundancies, cloud computing, virtualization, hot, warm or even cold failover can mitigate and reduce lost time, and increase productivity. A properly drafted force majeure clause should require the vendor to make all efforts to comply with its contractual obligations, despite the force majeure. The clause should also define a force majeure event as narrowly as possible.

Even if a valid event occurs, at some point the vendor has to either find a way to deliver the services or the customer should be able to find alternate sources for the services and terminate the contract. This should be memorialized in the contract.

It should be made clear that a force majeure event would not excuse any confidentiality or other obligations not directly affected by the force majeure event. The clause should also specifically state that a failure by a subcontractor is not a force majeure event.

In addition to force majeure clauses, here are more suggestions for any outsourcing agreement in order to address the risks of natural disasters like Sandy. Every outsourcing provider should have a disaster recovery plan. Companies must understand their vendor's plan, and even make it part of the contract. It may be possible to have the outsourcing vendor agree to provide the service through alternate

means. There are many options available (cloud computing, shared networks, etc.) and there are risks associated with each. Any outsourcing customer should know and understand these risks.

In disaster recovery planning, here are some important questions to ask. What are the most important business processes? Which end users are crucial to those processes? What software, systems or other technology services which support those business processes? What are the minimal and optimal service levels for each of those services?

The answers to these questions will drive the choices for implementation of a disaster recovery plan. The disaster recover solution should be flexible and transparent. Finding appropriate vendors to implement these requirements can be a challenge. However, if outsourcing customers wish to avoid a repeat of the effects of Sandy, then it is a challenge worth undertaking. ♦

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